United States Court of Appeals

for the Second Circuit

REPLY BRIEF

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FOR THE SECOND CIRCUIT

B

ALAN B. MILLER, as Trustee in Bankruptcy of AMERICAN IBC CORP., Bankrupt,

Plaintiff-Appellee,

-against-

WELLS FARGO BANK INTERNATIONAL CORP.,

Defendant-Appellant.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

SUR-REPLY BRIEF OF TRUSTEE-APPELLEE

WEIL, GOTSHAL & MANGES
Attorneys for Trustee-Appellee
Alan B. Miller, Trustee in
Bankruptcy of American IBC Corp.
767 Fifth Avenue
New York, New York 10022
(212) 758-7800

Harvey R. Miller
Robert A. Weiner
Fredric J. Leffel
Of Counsel

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Bankruptcy of American IBC
Corp.
767 Fifth Avenue
New York, New York 10022
(212) 758-7800

Harvey R. Miller
Robert A. Weiner
Fredric J. Leffel
Of Counsel

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PRELIMINARY STATEMENT

Alan B. Miller, as Trustee in the Bankruptcy of American IBC Corp., Bankrupt, ("Trustee"), submits this sur-reply brief in response to the reply brief submitted by Wells Fargo Bank International Corp., Defendant-Appellant (the "New York Bank") on May 18, 1976.

The Trustee will address three legal issues raised by the New York Bank, and two factual misstatements contained in the New York Bank's reply brief, as follows:

1. The 1970 General Pledge Agreement did not give the New York Bank any lien or security interest in the Wells Fargo Luxembourg time deposit account or in the Swiss francs deposited by American IBC Corp. ("AIBC") in that account.

2. The repayment of the second loan on November 19, 1973 constituted a transfer, as defined in the Bankruptcy Act, of property of AIBC.

3. The New York Bank has failed to demonstrate that AIBC could not have used the time deposit contract issued by Wells Fargo, Luxembourg to obtain a "false credit."

4. AIBC issued the instructions regarding the disposition of the proceeds of the time deposit accounts and the U. S. dollar proceeds of the foreign exchange contracts with Swiss Credit.

5. The question as to whether the funds used to make the loan repayment in McKenzie v. Irving Trust Co. constituted "property of the debtor" was not an issue before the McKenzie court.

I

THE 1970 GENERAL PLEDGE AGREEMENT DID NOT GIVE THE NEW YORK BANK ANY LIEN OR SECURITY INTEREST IN THE WELLS FARGO LUXEMBOURG TIME DEPOSIT ACCOUNT OR IN THE SWISS FRANCS DEPOSITED BY AMERICAN IBC CORP. ("AIBC") IN THAT ACCOUNT.

In its ex post facto attempt to come up with some basis for a security interest in connection with the first loan transaction, the New York Bank argues that the 1970 General Pledge Agreement operated as an assignment of the Wells Fargo Luxembourg time deposit account. Unless words are not to be taken to mean what they say, however, the General Pledge Agreement did nothing of the sort.

The General Pledge Agreement, App. at E181 (Exhibit F), provides that "the undersigned [AIBC] hereby assign, transfer to and pledge with Bank all money and property this day delivered to and deposited with Bank...or which shall hereafter be delivered to or come into the possession, custody or control of Bank...." [Emphasis supplied.] "Bank" is earlier defined as "WELLS FARGO BANK INTERNATIONAL CORPORATION." The General Pledge Agreement nowhere provides that it covers property deposited with or delivered to agents, correspondents or affiliates of the New York Bank.

From the very language of the General Pledge Agreement, therefore, it is evident that it did not even purport to confer a lien or security interest in the Swiss francs on deposit with Wells Fargo Luxembourg. Those Swiss francs were never "delivered and deposited with" the New York Bank, and never came into the "possession, custody or control" thereof. The funds were on deposit with Wells Fargo Luxembourg. AIBC, as depositor, had possession of the funds and Wells Fargo Luxembourg, as the depository, had custody. Craig v. Gudim, 488 P.2d 316, 319 (Wyo. 1971). As evidenced by the time deposit contract, App. at E5 (Exhibit 3), AIBC had control. The New York Bank's telex test key facility with Wells Fargo Luxembourg did not give it control over the time deposit account or the disposition of the Swiss franc proceeds. The District Court made a specific finding of fact rejecting this contention. App. at 180-81.

In addition, the General Pledge Agreement did not operate as a "transfer" of any interest in the time deposit account or Swiss francs under the test set forth in Section 60a(2) of the Bankruptcy Act, 11 U.S.C. §96a(2). Even assuming arguendo that the General Pledge Agreement could have created an assignment, any security or lien interest

founded thereon would amount to nothing more than a secret lien as against third parties. As set forth in the Trustee's answering brief at pages 55-57, the test set forth in Section 60a(2) of the Bankruptcy Act, supra, precludes any lien or security interest which is not accompanied by some sort of public notification of the interest, such as a filing pursuant to a recording statute or possession. See also, Bankruptcy Act §60a(6), 11 U.S.C. §96a(6).

In sum, the General Pledge Agreement, entered into in 1970, in no way obviated the need to obtain possession of some indispensable instrument in order to perfect an interest in the Wells Fargo Luxembourg time deposit account. It was not self-executing, and the New York Bank's utter failure to take any steps to perfect a security interest in the time deposit account precludes the existence of any perfected assignment founded thereon.

II

THE REPAYMENT OF THE SECOND LOAN ON NOVEMBER 19, 1973 CONSTITUTED A TRANSFER, AS DEFINED IN THE BANKRUPTCY ACT, OF PROPERTY OF AIBC.

The New York Bank in its opening and reply briefs puts forward a fanciful theory that the repayment of the second loan on November 19, 1973 did not result in a dimi-

nution of the estate of AIBC because the repayment did not constitute a transfer of property of the debtor. This argument flies in the face of the facts in the record and of applicable law.

The New York Bank's discussion of this theory, especially in its reply brief, distorts the factual and legal issues which are properly before this Court. The Trustee is therefore constrained to set forth briefly the salient principles of law regarding the "transfer of property of the debtor" requirement in Section 60a(1) of the Bankruptcy Act, 11 U.S.C. §96a(1).

The first element of a preferential transfer under Section 60a(1) of the Act is that there must be "a transfer, as defined in this Act." Section 1(30) defines "transfer" as follows:

> "'Transfer' shall include the sale and every other mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge, mortgage, lien, encumbrance, gift, security, or otherwise; the retention of a security title to property delivered to a debtor shall be deemed such

a transfer suffered by such debtor." [Emphasis supplied.]*

The definition of "transfer" is intentionally broad. As stated in Wolf v. Aero Factors Corp., 126 F. Supp. 872, 882-883 (S.D.N.Y. 1955), aff'd, 221 F.2d 291 (2d Cir. 1955),

> "[t]he word 'transfer' in the statute is used in its most comprehensive sense, and is intended to include every means and manner by which property can pass from the ownership or possession of a debtor to a creditor and by which the 'preference' forbidden by the statute may be accomplished. Pirie v. Chicago Title & Trust Co., 182 U.S. 438, 21 S.Ct. 906, 45 L.Ed. 1171. A 'transfer' can be made by a bankrupt although he may have been altogether passive, as where his property is taken from him on an execution sale. Adler v. Greenfield, 2 Cir., 83 F.2d 955." [Emphasis supplied.] See also Grandison v. Nat'l Bank of Commerce, 231 Fed. 800, 803 (2d Cir. 1916), cert. den., 242 U.S. 644 (1916).

Section 60a(1) of the Act, supra, reinforces the Section 1(30) definition by providing further that a preferential transfer may be one "to or for the benefit of a creditor... made or suffered by such debtor." [Emphasis supplied.]

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* Repayments to banks of outstanding loans are held under this definition to constitute transfers for purposes of satisfying the transfer requirement of Section 60a(1). Goldstein v. Franklin Square Nat'l Bank, 107 F.2d 393, 394 (2d Cir. 1939); Mayo v. Pioneer Bank & Trust Co., 270 F.2d 823, 836 (5th Cir. 1959), cert. den. 362 U.S. 962 (1960),

The plain effect of these provisions is that the intent or willfulness of the debtor is immaterial to the issue of whether a transfer of his property has occurred.

> "There would seem to be little doubt, therefore, that under the Act of 1938, a voidable preference may be effected irrespective of any voluntary action on the part of the debtor with reference to the transfer of his property. Sound reason supports this attitude, for since the debtor's intent is immaterial, the trustee should be empowered to avoid a transfer that falls within the definition of a 'preference' under §60a and is voidable under §60b even though the debtor contributes nothing to the transaction of his assent, voluntary act or passive acquiescence." 3 Collier, Bankruptcy ¶60.09 at 799 (14th ed. 1975). [Emphasis supplied.]

Accordingly, AIBC's intent is immaterial under Sections 1(30) and 60a(1) of the Act, supra. Indeed, a preferential transfer may be effected against the debtor's wishes. 3 Collier, Bankruptcy ¶60.09 at 799 & n.8 (14th ed. 1975).

Moreover, the transfer need not be made by the debtor at all as long as it is made out of his estate. Nat'l Bank of Newport v. Nat'l Herkimer County Bank, 225 U.S. 178, 184 (1912); Smyth v. Kaufman, 114 F.2d 40, 42-43 (2d Cir. 1940); Steel Structures, Inc. v. Star Manufacturing

Co., 466 F.2d 207, 217-218 (6th Cir. 1972); Palmer v. Radio Corp. of America, 453 F.2d 1133, 1136 (5th Cir. 1971); Aulick v. Largent, 295 F.2d 41, 50-51 (4th Cir. 1961). The property can come from a third party and need not have passed through the debtor's hands, so long as it was the debtor who indicated the creditor and debt to be paid. Aulick v. Largent, 295 F.2d 41 (4th Cir. 1961); Smyth v. Kaufman, supra; Interstate Nat'l Bank of Kansas City v. Luther, 221 F.2d 382 (10th Cir. 1955), cert. granted, 350 U.S. 810 (1955), dismissed per stipulation, 350 U.S. 944 (1956).

The facts adduced at trial conclusively establish that American IBC repaid Wells Fargo International the full amount due on the loan transactions and American IBC's bankrupt estate was diminished accordingly.

The transfers of AIBC's property occurred when the New York Bank effected repayment to itself. This was accomplished by the physical act of debiting the account of AIBC. Deposits into a bank account which are earmarked as repayments of outstanding loan obligations to a bank are held to be "transfers" under Section 60a(1) when so applied by the depository bank. Mechanic's and Metals National

Bank v. Ernst, 231 U.S. 60, 66-67 (1913); Blue v. Herkimer Nat'l Bank, 30 F.2d 256, 259 (2d Cir. 1929); Bank of Commerce & Trusts v. Hatcher, 50 F.2d 719, 721 (4th Cir. 1931). Accordingly, it is manifest that AIBC made or suffered a "transfer" of its property to the New York Bank on November 19, 1973, when the latter received the loan repayment.

The New York Bank continues to insist in its reply brief that the August 29, 1973 telex from AIBC to Swiss Credit, App. at E41 (Exhibit 19), granted Swiss Credit a security interest on the proceeds of the November 19, 1973 foreign exchange contract. That contention, as the District Court properly noted, is irrelevant. App. at 170.

Moreover, the authority cited by the New York Bank--the "uncontroverted" affidavit submitted on its behalf by a Swiss attorney--is hardly conclusive on the lien issue. The August 29 telex was merely a revocable instruction to Swiss Credit to pay itself out of a designated fund to come into existence in the future (on November 19, 1973) for whatever debts of AIBC to Swiss Credit might be outstanding as at November 19, 1973. It certainly could not have amounted to an assignment under the law of New York. McCloskey v. Chase Nat'l Bank, 285 App. Div. 148, 152-53

(1st Dept. 1954), aff'd, 308 N.Y. 998 (1955); Williams v. Ingersoll, 89 N.Y. 518 (1882); Donovan v. Middlebrook, 95 App. Div. 365, 367 (1st Dept. 1904). The notion that a private, revocable telex could have conveyed a perfected security interest that would pass muster under Section 60a(2) is nothing short of astonishing. Once again, it appears that what the New York Bank is attempting to pass off as a valid, perfected security interest is simply a secret lien. Furthermore, in view of the conclusion urged by the New York Bank under Swiss law that Swiss Credit had a perfected, subsisting security interest, it should be noted that Swiss Credit has not filed a proof of claim as a secured creditor in the AIBC bankruptcy case. Indeed, the claim filed by Swiss Credit is unsecured and is based upon an indebtedness entirely unrelated to the loan transactions involved in this appeal. App. at 195 (R. 231, 239-41).

Even assuming for the purposes of argument the fact that Swiss Credit had a lien on the proceeds of the November 19 foreign exchange contract, it is clear that Swiss Credit never realized on its alleged collateral--the U.S. dollar proceeds of the November 19 foreign exchange contract--in satisfaction of AIBC's outstanding debts.

Swiss Credit's statement of the AIBC dollar account demonstrates conclusively that no setoff or other liquidation of the "collateral" ever occurred; rather, it indicates that the proceeds of the foreign exchange were in fact credited to AIBC's account pursuant to AIBC's original instructions. App. at E222 (Exhibit AE). In fact, Swiss Credit conceded as much in its December 12, 1973 telex to the New York Bank, quoted at page 75 of the Trustee's answering brief. App. at E196 (Exhibit Q).

Thus, the dollars which were forwarded to AIBC's account at the New York Bank on November 19, 1973, and which were used by the New York Bank to liquidate the $1,000,000 loan of May 15, 1973 constituted property of AIBC. The repayment transaction therefore resulted in a preference to the New York Bank.

III

THE NEW YORK BANK HAS FAILED TO DEMONSTRATE THAT AIBC COULD NOT HAVE USED THE TIME DEPOSIT CONTRACT ISSUED BY WELLS FARGO LUXEMBOURG TO OBTAIN A "FALSE CREDIT."

The District Court found that, apart from the New York Bank's failure to obtain any valid pledge of the Wells Fargo Luxembourg time deposit, it "permitted the existence of conditions under which the bankrupt could easily make it

appear to potential creditors that the Swiss Franc time deposit was an unencumbered asset" by Wells Fargo Luxembourg's issuance of the time deposit contract to AIBC and by AIBC's continued possession thereof. App. at 141-42. As the District Court noted, the primary policy back of the delivery requirement is to prevent the pledgor from being able to derive a "false credit" from apparent ownership of the item pledged. Id.; In re Copeland, 391 F.Supp. 134, 151 (D.Del. 1975). The District Court concluded that AIBC's possession of the time deposit contract, App. at E5 (Exhibit 3), violated this policy. App. at 142.

The New York Bank, in its opening and reply briefs to this Court, insists that under New York law creditors are not entitled to rely on the sort of document possessed by AIBC as evidence of ownership of the account. The only cited authority for this proposition is First National Bank v. Clark, 134 N.Y. 368, 372 (1892). Appellant's Brief at 25-26; Appellant's Reply Brief at 5. The document involved in Clark, however, was quite different from the time deposit contract issued by Wells Fargo Luxembourg in the appeal at bar. The document issued by the bank in Clark was merely a receipt which acknowledged the amount and date of a deposit.

It did not recite any promise to pay the sum deposited. Nothing would have assured anyone that the funds which were deposited on the date indicated had not been withdrawn from the account. 134 N.Y. at 372. Not surprisingly, then, the New York Court of Appeals concluded as follows:

> "It is not proof of liability, and it will not support an action against the bank." Id.

In contrast, the time deposit contract issued by Wells Fargo Luxembourg is expressly labelled "Contract." It indicates not only that AIBC deposited 3,240,000 Swiss francs on May 5, 1973, but also recites with specificity the repayment obligation of Wells Fargo Luxembourg, to wit, the obligation to pay AIBC 3,309,997.50 Swiss francs on November 2, 1973, representing the principal amount of the deposit plus interest at the rate of 4.25 per centum. The time deposit contract thus suffers from none of the infirmities that characterized the receipt in Clark. Therefore, the New York Bank's argument that potential creditors of AIBC were not entitled to rely upon the time deposit contract as an indication of AIBC's ownership thereof is unsupported and spurious.

IV

AIBC ISSUED THE INSTRUCTIONS REGARDING THE DISPOSITION OF THE PROCEEDS OF THE TIME DEPOSIT ACCOUNTS AND THE U. S. DOLLAR PROCEEDS OF THE FOREIGN EXCHANGE CONTRACTS WITH SWISS CREDIT.

In a transparent attempt to bootstrap itself into a position of having controlled the "flow of funds," the New York Bank blatently distorts the record in two instances in its reply brief. At page 12, the New York Bank states as follows:

> "[T]he Trustee's description of the instructions which were sent by the Luxembourg affiliate, not AIBC, is incorrect. The New York Bank instructed the Luxembourg affiliate to remit the Swiss francs to SCB and to order SCB to send the dollar equivalent to the New York Bank. [Ex. A (E174)]"

The exhibit referred to by the New York Bank is the May 2, 1973 letter of William Boland ("Boland") confirming the terms of the first loan. The letter to which Boland is responding is AIBC's letter of April 30, 1973, in which Sheldon Silverston, President of AIBC, ("Silverston") makes the following request:

> "We ask you to instruct Wells Fargo Luxembourg for us to deliver this sum through Swiss Bank Corp. Zurich, to Swiss Credit Bank, Zurich in favor of

> American IBC Corp. attention Mr. Ribi. We have instructed Swiss Credit Bank to deliver to Wells Fargo Bank International Corp. in New York, value November 2, 1973, the sum of U.S. $1,042,814.37." App. at E2 (Exhibit 1) [Emphasis supplied.]

In his responding letter of May 2, 1973, Boland reports that he has conveyed Silversteon's instructions to Wells Fargo Luxembourg:

> "As requested in your letter of April 30th, we have requested Wells Fargo Bank, Luxembourg, to pay through Swiss Bank Corp., Zurich...." App. at E3 (Exhibit 2).

Boland then quotes the telex which he actually sent to Wells Fargo Luxembourg. This telex instructs the Luxembourg bank to pay the proceeds of the time deposit account at maturity to Swiss Credit, and to indicate in their remittance "attention Mr. Ribi Swiss francs 3,308,850, credit dollar equivalent 1,042,814.37 to WFBI for account American I.B.C. attention Boland." App. at E4 (Exhibit 2). As can be seen in the remittance instructions from Wells Fargo Luxembourg, App. at E221 (Exhibit AD), that is precisely the message which Wells Fargo Luxembourg gave to Swiss Credit when it forwarded the proceeds of the time deposit account on November 2, 1973. Thus, there can be no question

but that AIBC, not the New York Bank, directed that the proceeds of the Wells Fargo Luxembourg time deposit account be disposed of in the manner that they were. It is also manifest that Boland understood this and that he was only acting at the behest of AIBC in forwarding these instructions on to Wells Fargo Luxembourg.

A similar distortion of the record occurs at page 21 of the New York Bank's reply brief, where it is stated as follows:

> "The district court's conclusion that AIBC could have issued different instructions to SCB, and diverted the funds, is erroneous since the Luxembourg affiliate issued the instructions at the direction of the New York Bank. The Trustee does not dispute that the bank transmitting funds is the agent the sender. Here, the remittance instructions which controlled the transfer of the funds were issued by the Luxembourg affiliate which was the agent of the New York Bank."

The New York Bank then goes on to quote Exhibit AD. However, as has been indicated in the preceding paragraphs, it is patent that this instruction was sent pursuant to the instruction given by Silverston to Boland in the former's letter of April 30, 1973. The New York Bank, however, gives the impression that the instructions contained in Exhibit AD originated with the New York Bank, by stating

that the wording of the Exhibit AD instructions was dictated by the New York Bank. For this proposition, it refers to the telex sent by Boland at the request of Silverston in his letter of April 30, 1973.

The truth is, of course, that the instructions sent by Wells Fargo Luxembourg to Swiss Credit originated with AIBC. Moreover, these instructions were nothing more than a repetition of the instructions AIBC had itself issued to Swiss Credit six months previously. App. at E145 (Exhibit 52, ¶19).

The New York Bank is disingenuous when it tries to suggest that it, and not AIBC, controlled the "flow of funds" through the time deposit, foreign exchange and loan transactions. These assertions are contradicted by the documentary evidence and by the findings of fact of the District Court. Moreover, the New York Bank has stipulated to the facts relating to the directions for the transfer of funds by Wells Fargo Luxembourg and by Swiss Credit, as set forth in the statement of facts contained in the Trustee's brief. App. at E143-46 (Exhibit 52, ¶¶10-27).

Once again, the bank is trying to cloud a simple truth: that in April, 1973, AIBC approached the Bank with a

foreign exchange transaction for which it required financing, that the New York Bank merely reviewed the transaction AIBC had arranged for itself, and that the Bank lent AIBC $1,000,000 on the apparent risklessness to AIBC--and therefore to itself--of the transaction. The New York Bank's belated attempt to alter the established facts must be rejected.

V

THE QUESTION AS TO WHETHER THE FUNDS USED TO MAKE THE LOAN REPAYMENT IN McKENZIE v. IRVING TRUST CO. CONSTITUTED "PROPERTY OF THE DEBTOR" WAS NOT AN ISSUE BEFORE THE McKENZIE COURT.

Symptomatic of the New York Bank's approach to the facts and the law in this appeal is its misrepresentation, at page 34 of its reply brief, of the issues in McKenzie v. Irving Trust Co., 292 N.Y. 347 (1944), aff'd, 323 U.S. 365 (1945). The Trustee has distinguished McKenzie at page 78 of its brief. However, in the New York Bank's reply brief the argument is made that the trustee in bankruptcy in McKenzie had contended that the creditor bank's crediting and subsequent debiting of the debtor's account had passed funds which initially had not been in the debtor's estate into the estate, so that the debiting of the account to effect the loan repayment would amount to a preference. The New York Bank then contends that the argument in McKenzie

is analogous to the argument made by the Trustee in the appeal at bar at page 77 of his brief. Finally, the New York Bank contends that the argument was rejected by the McKenzie court.

It is apparent from a reading of McKenzie that the New York Bank's argument is a complete fabrication. There is nothing in the reported decision indicating that the trustee made the argument the New York Bank states was made; indeed, there was simply no question that the funds used to make the repayment were "property of the debtor." The funds came from the bankrupt's check drawn on its account to the order of the bank. The only real issue in the case which has any conceivable relevance to the instant appeal is that the transfer was deemed to have occurred when the bankrupt mailed the check to the bank, which occurred more than four months before bankruptcy, rather than on the date when the debtor's account was debited. 292 N.Y. at 359.

Therefore, the argument of the New York Bank based on an analogy to the McKenzie case should be disregarded.

CONCLUSION

The judgment and order of the District Court should be affirmed in all respects.

Respectfully,

WEIL, GOTSHAL & MANGES
Attorneys for Plaintiff-Appellee
Allan B. Miller, as Trustee
in Bankruptcy of American
IBC Corp., Bankrupt

Harvey R. Miller
Robert A. Weiner
Fredric J. Leffel,
Of Counsel